INTRODUCTION

1.1 The Low-Income Housing Tax Credit (LIHTC)

Tax Credit Overview

The Tax Reform Act of 1986 established a tax credit for low-income rental housing that was directly based on the number of low-income tenants residing in the complex. Section 252 of the Act and Section 42 of the Internal Revenue Code (IRC) govern the Low-Income Housing Tax Credit (LIHTC) program that began in 1987 and received permanent authorization with the Omnibus Budget Reconciliation Act of 1993. The LIHTC program provides incentives for investment of equity capital in the development of affordable single family or multifamily rental housing. The credit is a dollar-for-dollar reduction in tax liability to investors in exchange for equity participation in the construction or acquisition and rehabilitation of rental housing units that will remain income and rent restricted for an extended period of time.

Credits at 9% or 4%

Credits are allocated based on a federal economic formula of 9% for non-federally subsidized projects or below market rate interest deals, i.e., “conventional” developments, or 4% if the project is federally subsidized or given an interest subsidy, such as tax-exempt bonds or Rural Development. The acquisition credit for existing buildings is always 4%. Developers may be for-profit or nonprofit. Investors, often represented by limited partnerships, apply the tax credits to reduce their income tax liabilities. Individuals can claim Credits up to the equivalent of a $25,000 deduction. Corporate and bank investors have no limit on credit amount.

Qualified Allocation Plan

Hawaii’s Qualified Allocation Plan (QAP) includes guidelines for the competitive ranking of applications. The amount of credits given to each state is based on population for 2002 at a rate of $1.75 per person. Hawaii may also have credits from previously unallocated or returned credits or by using the credits originally allocated to other states that failed to use them. The latter are referred to as credits from the “National Pool.”

Many recognize the tax credit’s influence on development, but its effect on management must also not be minimized. In order for properties to qualify initially for the LIHTC, at minimum, follow all tax credit regulations throughout a 15-year compliance period. From a management perspective, a thorough understanding of the tax regulations governing this program is imperative.

1.2 Purpose of the Tax Credit Compliance Manual

Purpose of the Manual

This manual is intended to help owners and managers of LIHTC projects in the State of Hawaii fulfill their obligations in maintaining compliance pursuant to Section 42 of the IRC. The *General Explanation of the Tax Reform Act of 1986* (the "Blue Book") [Section 8], IRC Section 42 regulations [Section 9], and excerpts from HUD Handbook 4350.3 [Sections 22-24] are included in this manual for reference. Additional Hawaii requirements for owners of a tax credit property are delineated in the Declaration of Restrictive Covenants for Low-Income Tax Credits.

Reference for owners and managers

Owners are responsible for being aware of all applicable federal and state rules and regulations that govern their properties.

This manual focuses on the responsibilities of owners and managers of LIHTC projects from the beginning of the lease up period through the end of the compliance period. Subjects discussed include:

- Owner's recordkeeping requirements
- Occupancy regulations
- Properly evaluating tenant income, assets and eligibility at move-in and at re-certification
- Determining the maximum gross rent for units
- Regulatory considerations when leasing vacant units

Sample forms, including those required for tenant certification procedures, are provided in Section 6 of this manual. "Required" forms are specified in the instructions for that section. *Upon approval, other income or asset verification forms may be substituted for those provided in this manual.*

In the State of Hawaii, the Housing and Community Development Corporation of Hawaii (HCDCH) is the housing credit agency administering LIHTC allocations. HCDCH is dedicated to providing quality affordable housing and is committed to helping owners of LIHTC properties understand and fulfill their obligations under the program. This manual is intended as a reference to promote a better understanding of the LIHTC program.

1.3 Credit Period

Credit Period

Credits given over a 10-year period

Once an LIHTC allocation has been finalized for a property, the tax credits can be claimed annually on a building-by-building basis over a 10-year period, beginning either with

(a) the taxable year in which the building is placed in service, or
(b) at the election of the taxpayer (owner), the succeeding taxable year.

The election under subparagraph (b), once made, is irrevocable. No credits are given if the building does not comply with IRS regulations for meeting initial compliance. This means that eligible households must occupy the required number of units throughout the ten-year credit period plus an additional five (5) year term (*see "Compliance Period"*). The housing units designated for the LIHTC must also be rent-restricted for a specific period of time.

1.4 Compliance Period

Compliance Period

Compliance required for 15 years.

The tax credit program requires fifteen (15) years of continuous compliance, but allows the credit to be taken over a ten (10) year period. Beginning with 1990 allocations (and no later than 1991) state housing credit agencies began the requirement of extended low-income housing commitments that are recorded in local land records. Owners of these developments must agree to commit to an additional 15-year low-income use of the project beyond the initial 15-year compliance period. It is important for management to understand that such projects are committed to a minimum 30-year time frame of compliance with tax credit eligibility requirements.

If a building is not initially qualified by end of the first year of the credit period, tax credits associated with unqualified units will earn two-thirds credit over the compliance period.

Extended low-income use period

The extended use agreement binds that owner and any successors to maintain specific occupancy and affordability requirements for the projects. The agreement may list the exact number and size of units that must be low–income at designated income levels (including state deep skew set-asides), provisions for allowing staff units, and special needs groups to be served.

The extended use period may terminate for any building if:

(a) acquired by foreclosure, or

(b) the housing credit agency is unable to find a buyer in the 1-year period following the current owner's request in the last year of the compliance period to acquire the owner's interest in the low-income portion of the building.

Section 42 also provides that each individual state has the power to impose additional requirements over and above the federal standards to better address local housing needs inclusive of extending the period for which the property is kept as affordable housing, and HCDCH has used this authority to provide for an extended use period of more than thirty (30) years that is not subject to prior termination in certain cases, for example, if owners have obtained a higher ranking for their project in the application process by committing to extended affordability.

An additional factor complicating management of tax credit projects is that LIHTC properties are often coupled with subsidy programs (both project-based and tenant-based) that have other government housing regulations. There are times when conflicts between programs arise. *Care must be exercised to ensure that the most restrictive of these competing program requirements is met.*

Four Regulation Periods

1.5 Four Tax Credit Regulation Periods

Since the 1986 enactment of the LIHTC, Congress has changed or amended the laws governing the program, yet many changes have not been retroactive. In some cases, the change in regulations brought forth by a technical correction is minor; in others, the effect is substantial. Management must not only be aware of the differences in regulations, but must have full knowledge of what tax credit law applies to each particular building and/or project. The relevant law for management/ compliance purposes is that applicable to the year in which tax

The years referenced pertain to the allocation year.

credits were allocated by the state housing credit agency. Currently, there are four specific tax credit regulation periods as follows:

I. January 1, 1987 – December 31, 1989

Properties receiving credit allocations during this period based rent on the number of people living in the unit. Rents were subject to change whenever the household composition changed. The Omnibus Reconciliation Act of 1993 allowed owners of these projects a one-time opportunity to either maintain the per person rent formula or elect to change to the formula based on apartment bedroom size used for 1990 and later allocations. The owner had to write to the IRS no later than February 6, 1994 to request this election. Once made, the decision to switch formulas or not was irrevocable. The new rent formula only affected new move-ins on or after the election date. A copy of the election letter must have been provided to HCDCH or its Authorized Delegate and must be available during any compliance review.

II. 1990

- Rent is calculated by number of bedrooms in a unit (not retroactive).
- Gross Rent Floor adopted (not retroactive).
- Extended Low-Income Housing Commitment required.

III. 1991

- AFDC Student Rule exception (retroactive).
- FmHA Overage Rule (not retroactive).
- Extension on Initial Compliance with Set-Aside (not retroactive).

IV. August 10, 1993

- Married Students Rule (retroactive).
- Single Parent Student Rule (not retroactive).
- 1987-89 Rent Change Option (special rule).
- Section 8 requirement (retroactive) where projects cannot refuse to lease to Section 8 tenants.

Two Additional Rulings

1.6 Additional Revenue Rulings

Two important revenue rulings were later issued that were not retroactive.

I. September 9, 1992

- IRS Revenue Ruling 92-61 deals with treatment of staff units as part of the eligible basis [Section 13].

II. September 26, 1997

- Section 1.42-15 Available Unit Rule was adopted as an amendment to the regulations. This rule allows over-income persons in LIHTC units to relocate to another unit in the same building [Section 21].